Abridgment of the book of

Justice (Retd) ***Muftī Muḥammad Taqī ʻUsmānī*** *titled*

'An Introduction to Islamic Finance'

SHARĪʻAH BASIS OF

THE PRODUCTS

OF

ISLAMIC BANKS

Shafiq ur Raḥman

بسم الله الرحمان الرحيمْ

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PRELUDE

Although his vast research on multiple issues of *Sharī'ah* Law is spread over in a dozens of books in many languages, the book "Introduction to Islamic Finance"[1] written by Justice (Retd) Muftī Muḥammad Taqī Usmānī (*Dama Majdohu)* is considered to be among consolidated works on the Islamic finance wherefrom the products of Islamic Banks (IBs) have been largely emanated. The book has also been translated by Maulāna Muḥammad Zāhid[2] (*Dama Majdohu)* in Urdu as "اسلامی بینکاری کی بنیادیں".

Once debate over lawfulness of prevalent Islamic Banking intensified after issuance of a *Fatwa* followed by a book on the issue by a group of respectable *Ulemā* in Pakistan since late 2008, this book and its translation has been frequently referred to and quoted by those in favour or against the contemporary set-up of IBs. These opposing *Ulemā* have opined, *inter alia,* that the banking prefixed with "Islamic" is nothing but strengthening the exploitative system historically rooted in the capitalism. The un-Islamic concepts of 'Juridical Person' & 'Limited Liability' of a company, the heavy dependence of IBs on *Ijārah* and *Murābaḥah* rather than real Islamic modes i.e. *Mushārakah* and *Muḍārabah* and visible flaws in the practice of IBs are also factors that have been made basis for criticism. Since emphasis of these *Ulemā* is on the point that Muftī Taqī Usmānī (*Dama Majdohu)* and his team have paved the way for the sector by providing the *Sharī'ah* fundamentals, therefore need was felt to have a summary of the book containing fundamentals of IB, hence this booklet.

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[1] Published by *Maktaba Ma'āriful Qur'an*, Karachi in 1999.

[2] Lecturer of *Hadith*, *Jāmia Imdādia* Faisalabad, published by *Maktaba al Ārifī,* Faisalabad.

Though response to the reservations of ‘*Ulemā* has been justifiably given by Muftī Taqī Usmānī (*Dama Majdohu)* himself as well as a number of other ‘*Ulemā* and the process is still going on, it seems apt to mention that the approach adopted by him in the book is very careful, well balanced and to the point. The areas where flaws were found in the working of IBs, repudiation in clear terms has also been endorsed. The last chapter of his book is bare testimony of it.

The process for Islamisation of Economy commenced in Pakistan as early as its independence[3] sooner efforts by various notable ‘*Ulemā* were also assumed which matured in early 1980s.[4] It is note worthy that scholars from different parts of Muslim world e.g. UAE, Saudi Arabia, Kuwait, Syria, Egypt, Malaysia, Bangladesh and Bahrain etc. undertook similar steps in their respective countries around the same time. The role of various organizations like IDB,[5] Islamic Fiqh Academy of Jeddah, Islamic Fiqh Academy of India, particularly AAOIFI[6] since the last quarter of 20th century in paving the way for Islamic Economics is highly commendable and involvement of Muftī Taqī Usmānī (*Dama Majdohu)* in these processes by one way or the other is also very obvious. Despite all this, opposition by the respectable ‘*Ulemā* to the system of IB tends to be unwarranted.

While it is agreed that the IBs have not been able to fully establish a banking system that is ideally in consonance with the tenants of *Sharī‘ah* and there is a lot more to do to attain distributive justice of Islam, it may be appreciated by all that

[3] State Bank of Pakistan’s initiatives taken in 1948 onward.

[4] In shape of a Report of Council of Islamic Ideology.

[5] Islamic Development Bank of Jeddah and its training institute, IRTI.

[6] Accounting and Auditing Organization of Islamic Financial Institutions at Bahrain which has a *Sharī‘ah* Board consisting of about 20 scholars of high repute from around the world.

there is no denial that the sector has greatly advanced towards *Ribā*-free banking around the world and time will prove that the system is not only viable but sustainable as well. The recent credit crunch has affected IB lesser than the conventional banks and financial institutions and people in the world even non-Muslims seem to be more inclined towards *Sharī'ah* products than the conventional ones.

As quoted 'differences among '*Ulemā* is blessing' (اختلاف العلماء رحمة), the debate and research work by both sides over last about one year has unearthed many new aspects of the issues in question which is nothing but blessing for public. It is believed that this is right time to beseech both sides of '*Ulemā* that the variations and deficiencies being found in the system may be overcome through sincere joint efforts under agreement of all the scholars at some forum. Lastly it is relevant to mention that Muftī Rafī 'Usmānī *(dama majdohu)* has been quoted as stating that both sides of '*Ulemā* have expressed their point of view with entire honesty and sincerity. It is now for the masses to adopt any of the two versions with no guilt or burden on any part.

May Almighty Allah accept all the efforts of these scholars towards practical implementation of the Islamic system in all the spheres of life.

Shafiq ur Rahman
Karachi
27 Ramdan 1430/18 Sep 2009

PRELIMINARY POINTS

1. **Belief in Divine Guidance:** The commands given by Almighty Allah cover all aspects of human life. These are neither exhaustive to straiten the human activities nor ambiguous to leave every sphere to the mercy of man. Human reason despite vast capabilities cannot claim to reach unlimited truth. It only works to a limit, beyond which it errs and is confused with desire. In some areas the human reason cannot give proper guidance. Therefore Almighty Allah provided the same through a chain of the prophets the last being Muhammad (SAW).

2. **Difference Between Capitalist and Islamic Economic Theory:** Secular Capitalism is not controlled by divine authority which results into imbalance in the society at the hands of those having unbridled powers. Evils from this attitude cannot be curbed until human-being submit to divine power. Islam does not negate market force, economy or private ownership. However, Islam puts certain restrictions on the economy to maintain balance, distributive justice and equality of opportunities. Thus *Ribā*, gambling, dealing in unlawful goods, short sales etc have been prohibited.

3. **Asset-Backed Financing:** Islamic financing is asset- backed, while conventional banks deal in money and monetary papers. Islam does not recognize trade in money, except in some cases. The profit earned through money itself is therefore 'interest' and prohibited and the profit earned through assets is allowed in Islamic system.

4. **Capital and Entrepreneur:** In capitalist theory, capital and entrepreneur are two different factors of production. Capital gets fixed while remaining goes to

entrepreneur. Islam on the other hand does not recognize it, as the partner who provides capital also shares risk factor, and thus is entitled to the extent of proportionate rate only.

5. **Present practices of Islamic Banks:** Islamic banks are criticized that they did not bring any change in the society. The criticism is not realistic as the banks are very few in number and are passing through their infancy stages while Governments do not support them either. Moreover the banks are working under constraints and on the rules of necessity and not ideal rules of Islam. This book deals with both, ideal as well as relaxed types of rules.

MUSHĀRAKAH

مشارکۃ

Introduction: *Mushārakah* means sharing. In trade it means joint enterprise of profit and loss sharing. In interest based transactions there is injustice either for debtor or for creditor. In *Mushārakah* it is all sharing of either profit or loss as the case may be, which makes it a transaction based on justice and equality.

Concept: *Mushārakah* has limited scope than *Shirkah* شرکۃ(as used in Islamic Literature) and denotes only *Shikat-ul-Amwal* شرکۃالاموال as discussed hereafter. *Skirkah* is mainly divided into two kinds.

a. *Shirkat-ul-Milk*: (شرکۃالملک) means joint ownership of a particular property. It can either be optional (by act of parties) or automatic (through inheritance etc.)

b. *Shirkat-ul-'Aqd:* (شرکۃالعقد) means joint commercial enterprise. It has three kinds.

  i. *Shirkat-ul-Amwal:* (شرکۃ الاموال) When money is jointly invested in an enterprise.

  ii. *Shirkat-ul-A'māl:* (شرکۃ الاعمال) When partners (e.g. tailors) jointly provide service to the customers and earning is distributed amongst them. This kind is also named as *Shirkat-ut-Taqabbul* (شرکۃالتقبل), *Shirkat-uṣ-Ṣanā'i* (شرکۃ الصنائع) or *Shirkat-ul-Abdān* (شرکۃ الابدان).

  iii. *Shirkat-ul-Wujooh:* (شرکۃالوجوہ) When no money is invested and partners take things/items on credit

from market on their reputation and sell them. The earning is divided as per agreed ratio.

<u>Basic Rules:</u> Generally all necessary ingredients of a valid contract must also exist in a valid *Mushārakah*. However, following are particular to *Mushārakah* contract.

<u>Profit:</u> Proportion of profit must be fixed at the time of contract. This proportion must be based on the basis of profit accrued and not on the basis of Capital. Fixing lump sum amount is not allowed in Islamic Law.

<u>Ratio of Profit:</u> *Imām Mālik* and *Shāfe'ī* are of the view that it is necessary for the profit be distributed exactly in the proportion of partner's investment. If one has 40% of investment the profit should also be 40%. *Imām Aḥmad* allows variation subject to agreement of partners while *Imām Abū Ḥanīfa* has simply allowed variation in ratio but in case one is sleeping partner, his ratio should not be more than other partners.

<u>Sharing Loss:</u> In case of loss, all scholars agree that it should be equally borne by the partners according to the ratio of their investment.

<u>Nature of Capital:</u> All Jurists agree that money (liquid) can be pooled up for *Mushārakah* as capital but they differ on the issue of making commodities as capital. *Imām Mālik* allows it on the condition that it should be first evaluated on market rate. *Imām Abū Ḥanīfa* and *Aḥmad bin Ḥanbal* have disallowed due to the fact that (i) the commodities are normally distinguishable therefore they can not be joined so as to constitute *Mushārakah*. (ii) in case of dissolution of *Mushārakah* the commodities are not re-distributable as some of them may

have been sold, and value might have been changed. Hence it is not practicable to return the commodity or its justified value to the partners. *Imām Shafi`i* says that if commodities are رواث الامثال *Zawatul Amthal* (compensatcable e.g. sugar, wheat) they can be made capital of *Mushārakah* and if they are رواثالقیم *Zawatul-Qiyam* (Non compensatable e.g. goats, sheep) they can not be made capital. The view point of *Imām Mālik* seems, to be more reasonable in today scenario.

<u>Management of *Mushārakah*:</u> Principally all partners should involve in management of *Mushārakah* but it can be restricted to some of them mutually. In such a case the sleeping partners shall not be allowed profit more than the ratio of their investment. While working jointly by all of them each shall be deemed to be an agent for and duly authorized by others.

<u>Termination of *Mushārakah*:</u> Following are the ways to terminate a *Mushārakah* Contract:

1. Through a notice by a partner to other partners; in such a case the assets shall if they were liquid, be distributed pro rata between the parties. If the assets are not liquidated, the partners may choose either liquidation or distribution. If they differ, distribution shall be preferred. If the assets are not distributable they shall be sold and sale proceeds shall be distributed.

2. On death of a partner; however his heirs may opt for drawing of the share from *Mushārakah* or may continue with the contract.

3. One of the partners becoming 'insane' or incapable of effecting commercial transactions.

Termination of *Mushārakah* without Closing Business:

If a partner wants to quit the *Mushārakah*, other partners may purchase his share by determining the price of share mutually. If there is a dispute, the leaving partner can force for liquidation or distribution. Although *Sharī'ah* law is silent on the issue, the partners at the time of agreeing on *Mushārakah* can write a condition that liquidation or distribution shall only be effected if majority of them consent to it. A single partner leaving the business shall only sell his share to others. *Hanbalī* jurists have however expressly permitted it, which seems most appropriate keeping in view today's economy and business trends.

MUDĀRABAH

مضاربه

If a person gives money to another person for investing in a business it is called *Muḍārabah*. The first partner (investor) is called *Rabb-ul-Māl* ربُ المال and other as *Muḍārib* مضارب (undertaker of business).

Difference between *Muḍārabah* and *Mushārakah* is:

1. In *Mushārakah* investment comes from all the partners; in *Muḍārabah* investment is provided by *Rabb-ul-Māl* only.

2. In *Mushārakah* all partners can participate in management; In *Muḍārabah*, *Rabb-ul-Māl* has no right to participate.

3. In *Mushārakah* loss is borne by all the partners; In *Muḍārabah* only *Rabb-ul-Māl* bears the monetary loss. However, if *Muḍārib* has negligently or dishonestly performed he can also be made liable for loss.

4. In *Mushārakah* liability of partners is unlimited therefore if the liabilities exceed the assets it shall be borne by each partner pro rata. In *Muḍārabah* the liability of *Muḍārib* is limited to the extent of capital provided by *Rabb ul Māl*, but if the *Rabb ul Māl* had allowed *Muḍārib* for incurring debts this liability does not remain limited.

5. In *Mushārakah* partners jointly own the assets therefore they are equally entitled to the increased value of the assets even if profit has not accrued. In *Muḍārabah* all the items purchased by *Muḍārib* are owned by *Rabb ul*

Māl. The *Muḍārib* can not demand share in increased value of the assets. He can only receive his agreed share in the profit of the business.

Business of *Muḍārabah*

Muḍārabah is of two kinds: *Muqayyadah* يهذة which is restricted to a particular business, and *Muṭlaqah* يطهت which is unrestricted, and investment in any kind of business can be undertaken. More than one person can also be given *Muḍārabah* in one transaction and all of them can utilize the money jointly. The share shall be distributed among them according to the agreed proportion. The *Muḍārib* is only authorized to do things that are done in normal course of business, but for extraordinary work, express permission from *Rabb ul Māl* is required.

Distribution of Profit

The proportion of share in profit must be agreed, at the beginning, to any ratio that suits the parties. It should not be lump sum of the profit for any party. Specific rate tied up with capital can also not be determined for one party. Fixed percentage of capital can also not be made for *Rabb ul Māl*. *Imām Ahmed* has however allowed daily allowance for food etc for *Muḍārib*. *Hanafīs* have allowed this daily allowance in outstation trips only and not in town where business is being undertaken.

Termination of *Muḍārabah*

Either party can terminate the *Muḍārabah* contract after giving a notice to that effect. The assets, if in cash, and profit shall be

distributed as per agreed ratio. Solid assets shall be liquidated for determining the profit.

Muḍārabah can be for a specified period (i.e. one year) according to *Hanafi* and *Hanbali* schools of thought, but *Imām Shafi`i* and *Mālik* have disallowed restricting *Muḍārabah* for a maximum time. Fixing a minimum time for *Muḍārabah* has not been discussed by the jurists, but as per general rules of Islamic Law, such restrictions can not be imposed. In today's circumstances, however, it seems appropriate to allow such a condition as it does not violate any principle of Islam.

Combination of *Mushārakah* and *Muḍārabah*

Muḍārabah and *Mushārakah* can be combined by the parties in a single transaction whereby *Muḍārib* also invests some money in the business with the money of *Rabb ul Māl*. The *Muḍārib* can fix two proportions in the deal first as a *Muḍārib* and second as a partner (*Sharīk* شریک). In such a case, *Muḍārib* will get more profit but they can agree differently also. The only condition is that sleeping partner in *Mushārakah* can not get percentage more than his share of investment.

MUSHĀRAKAH & *MUḌĀRABAH* AS MODES OF FINANCING

Although books of *Fiqh* are silent on the issue, *Muḍārabah* and *Mushārakah* can be invoked for financing a running business, if they are not repugnant to the following basic principles.

a. Financing does not amount to lending money only; instead it should be participation in business (*Muḍārabah*) or sharing in assets (*Mushārakah*)
b. The investor/financier must also share loss, if any.
c. The partners can fix ratio of profit mutually but a sleeping partner cannot claim more than his investment.
d. The loss must be borne in proportion to the investment.

Project Financing

Traditional method of *Mushārakah* and *Muḍārabah* can easily be adopted in this kind of financing. If whole project is financed it becomes *Muḍārabah*. If both sides invest, it becomes *Mushārakah*, and if management is with one party only, it is a combination of *Muḍārabah* and *Mushārakah*. Valuation of capital and distribution of profits would not be an issue as *Muḍārabah* and *Mushārakah* would have been affected from inception. While withdrawing, the financier can sell his share to the other party along with his profit. The other party can continue at his own or by selling the financier's share to a third party.

Securitization of *Mushārakah*

Securitization by way of issuing Certificates of *Mushārakah* can be made which become negotiable instruments. *Mushārakah* certificates represent pro rata ownership in the asset and do

not denote a loan. If certificates have been issued against liquid money they cannot be sold in market except at par value. If the certificates represent non-liquid assets, their sale in market is allowed on any amount agreed between the parties. Where assets are mixture of liquid and non-liquid assets, the jurists have differed on their sale in market on the price other than the face value. Classical *Shāfeʿī* school has disallowed such sale while *Hanafī* school has allowed the sale at amount greater than the amount of liquid assets on the analogy that the excess amount shall be deemed to be in exchange for non liquid assets. *Hanafī* jurists have allowed issuance of certificates even if the non-liquid assets are less than 50% subject to the condition that size of such assets should not be very negligible. Other schools, including contemporary *Shāfeʿī* school have allowed this sale only if the non-liquid assets are more than 50% of the whole assets.

Financing of a Single Transaction

Mushārakah and *Muḍārabah* can be used for financing a single transaction of day to day needs as well as imports and exports. In case of import if letter of credit (L/C) is opened without margin (without any payment by importer) it becomes *Muḍārabah* and if Letter of Credit (L/C) is opened with margin (some payment by importer) it becomes *Mushārakah* or combination of both. This *Mushārakah* can be for a specific period and on expiry, the financier can sell his share to importer on market rate or the amount agreed on the day of sale and not on day of entering in *Mushārakah*. *Mushārakah* and *Muḍārabah* can also be used for export more easily on agreed proportion of profit, as the financier can restrict exporter to abide by conditions of letter of credit and in case of default exporter will be responsible to bear the loss if it was

due to negligence. If there is no negligence on part of exporter, both parties will share the loss.

Financing of Working Capital

For running business, financing on the basis of *Mushārakah* can be used by one of the following ways:

1. **By evaluating the capital with mutual consent.** In this case the value of the existing business can be treated as investment by the person who is seeking finance (industrialist) and the amount given by the financier shall be treated as share in investment. The *Mushārakah* financing can be for a particular period. The profit agreed by the parties for financier shall not be more than percentage of his share in the investment. On expiry of *Mushārakah* the liquid and non-liquid assets shall be evaluated for determining the profit. Although traditionally it is not allowed but valuation can be treated as شىعنتيىعُىتConstructive Liquidation” as there is no specific prohibition on such liquidation in *Sharī‘ah* law

2. **Sharing the Gross Profit Only:** The above procedure may be difficult as it involves lot of calculations. Another solution is that instead of calculating net profit the parties may agree to make the gross profit (including indirect expenditures) as yardstick for distribution of profits amongst them. Here direct expenses (of raw material, labour, electricity etc) shall be borne by *Mushārakah*. In such a case the percentage of profit of the industrialist may be kept at higher side by increasing his ratio to cater for indirect expenses i.e. use of his machinery, building and staff by joint venture (*Mushārakah*) or it may be agreed that *Mushārakah* portfolio will pay a fixed rent to the client for use of machinery/building. This way is allowed in *Hanbalī* school of thought.

3. **Running *Mushārakah* account on the basis of Daily Products**: Some times a running account is opened by the financial institutions to finance the working capital of an enterprise wherein clients draw and deposit money on daily basis. On maturity, the interest is calculated on daily product basis. No specific provision on validity of this type of account is found in Islamic Law. However it can be used as *Mushārakah* subject to general conditions i.e.:

(a) certain percentage must be allocated for management,
(b) The remaining amount must be allocated for investors,
(c) The loss, if any, should be borne by Investors in proportion of their investment,
(d) The average balance of contributions calculated on the basis of daily products shall be treated as 'share capital' of the financier,
(e) The profit shall be calculated and distributed on daily product basis. These arrangements however need further consideration deliberation and research by Islamic scholars.

Some contemporary scholars have raised two consecutive objections;

(1) this is conjectural method and is not based on actual calculation as there may be variation in profit on different dates. This query may be refuted on the ground that once pool is generated in *Mushārakah* it is not necessary that each partner get profit of his own money only. They can share profit even if some of the partners have not physically deposited money. Physically mixing of contributions of partners is not necessary in *Hanafī* school of thought. In this case the amount of capital of *Mushārakah* is known.

(2) In case of modern *Mushārakah* when clients are entering and leaving on daily basis the capital is not known. How can it be validated in the absence of exact knowledge of capital? The reply to this objection is that the *Mushārakah* is valid according to *Hanafī* school of thought even if capital is not known. Although, other schools of thought have different versions in the case.

SOME OBJECTIONS ON *MUSHĀRAKAH* FINANCING

1. **Risk of Loss:** Depositors are constantly at risk of loss as in *Mushārakah* arrangement the banks are at risk of passing loss to the industrialists. So the system will not succeed. Reply to this query is that the Islamic banks carry out in-depth study of the feasibility of the industrialist before financing as conventional banks also do, despite the fact that they provide money on fixed amount of interest. So chances of losses are minimal. Moreover, the *Mushārakah* is normally entered with many industrialists and all of them ending up in loss, is improbable.

2. **Dishonesty:** Some elements may exploit the *Mushārakah* mode by showing no profit or even showing total losses whereby the whole system of *Mushārakah* financing may collapse. This problem can be solved with the support of Central Bank and Government by exercising good auditing leading to punitive steps if disorder is found. This will reduce the chances of dishonesty. Moreover Islamic banks can start *Mushārakah* on selective basis with those clients only whose integrity is proven, particularly for export and import business where dishonest people fail and can not survive.

3. **Secrecy of Business:** Secrecy of business of industrialist is hampered as he would be supposed to show accounts to the banks. This problem of maintaining secrecy of client's account can be met by putting a special condition in the agreement that the financier will not interfere in management and will not disclose the information of client to any one.

4. **Client's unwillingness to Share Profits:** The clients (industrialists) normally avoid disclosing their profits

considering that: (1) why the bank should get more profit if he is just lender of money and does not undertake labour, and (2) to avoid disclosure of actual profits to tax authorities. To solve this problem the industrialists can be motivated for dealing with Islamic banks with the intention of avoiding interest being a cardinal sin. With the assistance of Central bank, the banks and industrialists can lobby with Government about changing the laws towards Islamisation of the sector and relaxation in taxes.

DIMINISHING *MUSHĀRAKAH*

يشاركِي خُلض

Diminishing *Mushārakah* means that the financier and client jointly own a property etc. The financier's share of investment is divided into units and the client purchases them periodically thereby gradually decreasing the financier's and increasing the client's share that end up into sole ownership of the client. During the period of *Mushārakah*, the client pays rent on agreed proportion to the financier according to his share in the property that gradually decreases, and ultimately the ownership is exclusively that of client.

House Financing on Diminishing *Mushārakah* Basis: In the house financing, following transactions would be involved:

1. To create *Shirkat ul Milk*, which is expressly allowed by all schools of thought.

2. Renting out of financier's share to client, which is unanimously allowed by all in case of joint ownership.

3. Promise by the client to purchase units of financier's share. It is also allowed by all jurists whether it is for land or building.

4. Actual purchase of units at different stages.

5. Adjustment of rent at different stages according to remaining share of financier.

The first three transactions are independently allowed but they can not be combined in a single transaction by making each a condition precedent for other. However, if one sided promise

is made by the client, the problem can be solved and according to some *Māliki* and *Hanafi* schools, promises are also enforceable by courts specially in commercial activities e.g. *Ba`i bil Wafa*, whereby the buyer after the purchase of a building promises with the seller that if the latter returns the price, he will resell the building to him. So a Diminishing *Mushārakah* can be used for house financing, (a) if all the above transactions are kept separate (only first two i. e. joint purchase and lease agreement can be combined), (b) Sale must be effected by offer and acceptance by both the parties and (c) it is preferable that sale of units is made on Market value.

Diminishing *Mushārakah* for Business of Services: For joint purchase of Taxi etc following ingredients are required.

i) Joint ownership (*Shirkat ul Milk*)

ii) *Mushārakah* in the income of taxi

iii) Purchase of units gradually. In this case, however the fact of depreciation may also be kept in view while making deal of purchase of units at different stages.

Diminishing *Mushārakah* in Trade: For *Mushārakah* in business presence of two ingredients must be taken care of.

i) *Mushārakah* should be as per rules permissible in *Shariah* Law.

(ii) Purchase of units gradually by the client after entering into a promise to that effect. In this case price of the unit can not be fixed at the stage of promise. So there are two options:

(a) to agree to sell the unit at the evaluated value of the business at the time of purchase.
(b) to get the unit bided first, and then sell the unit to the client on more than the offered rate. This second option may not be practically viable; therefore first option is a better option.

MURĀBAḤAH

مربحو

Originally, *Murābaḥah* is nothing but one of four kinds of sale with reference to cost and profit i.e. *Mnsawāmah* يسٍاو يّ *Murābaḥah* يربحٍ *Waḍī'ah* وضٍيع and *Tawlia* حٍويّ which respectively mean a sale by:

(i) bargaining on price (*Mnsawāmah* يسٍاو يّ),
(ii) taking profit on cost (*Murābaḥah* يربحٍ),
(iii) bearing loss in cost (*Waḍī'ah* وضٍيعٍ),
(iv) on no profit/no loss (*Tawlia* حٍويّ).

The cost is disclosed in last three types of sale.

<u>**Some Basic Rules of Sale:**</u> Sale means exchange of a valuable thing against a valuable thing with mutual consent of both the parties. The item being sold should be:

a. In existence (*Mawjūd* ويجٍيد)
b. Owned by seller (*Mamlūk* يٍٓيك)
c. In physical or constructive possession of the seller (*Maqbūḍ* يٍيبٍ ع) Exception: *Salam* and *Istisn'a* are two exceptions to these three principles.
d. Unconditional and instantly executable. (*Ghair Mashrūṭ* غٍير يشٍروط)
e. Valuable thing (*Mutaqawwam* يخٍيٍو)
f. Usable for lawful purposes (not be *Muḥarram al Iste'māl* يٍحرو الاسخٍعًال
g. Clearly pointed/identified in sale (*Ma'rifat ul Mabī'* يعٍيٍفت ألٍيٍيع).
h. Capable of being handed over immediately (*Maqdūr ut Taslīm* يٍمذوراٍلخٍيى

j. The price should be fixed and known. (*Ma'rifat ul Thaman* ٍ ً يعفت ث)

k. Free from void able conditions. (*Sharṭ ul Fasid* ذ شرطـفسل)

<u>*Bay' ul Mu'ajjal*</u>: (Sale with deferred Payment إج م ً بيعان)

1. If parties agree that payment in a sale is deferred it is called *Ba`i ul Mu`ajjal*

2. The date of payment should be fixed unambiguously. (*Ghair Mubham* غيب ى

3. Both, a fixed date or the time duration can be agreed. It can also be fixed with reference to some future event like time of harvest, arrival of pilgrims etc, but not with falling of rain or blowing of wind etc.

4. If duration is fixed, the period will start from the time of delivery unless otherwise agreed by the parties.

5. Deferred price can be more than cash price but it must be fixed at the time of contract.

6. The price once fixed can not be decreased/increased on the plea of early/late payment.

7. To ensure timely payment, a promise can be taken from the purchaser to pay a certain amount in charity but it should not be taken over/owned by the vendor.

8. A condition can be set that in case of default of an installment the purchaser will be bound to instantly pay the residual amount.

9. To secure payments, securities can be obtained from purchaser by way of mortgage or lien on his existing assets.

10. Promissory note or bill of exchange can be made but they can not be sold to a third person on different price than the face value.

***Murābaḥah*:**

1. When cost and profit (called mark up in *Murābaḥah* transaction) is expressly mentioned in the sale it is called *Murābaḥah*.

2. Markup (profit) can be fixed either by lump sum amount or by percentage.

3. Expenditures involved in acquisition (freight, taxes etc) can also be calculated while determining the cost, but not the recurring expenses i.e. wages of employees etc, as they can be considered while calculating the profit.

4. If the cost of a thing could not be ascertained, it shall not be *Murābaḥah;* instead it shall be called *Musāwamah*.

MURĀBAḤAH AS MODE OF FINANCING

Murābaḥah by itself is not a mode of financing and it is adopted only in exceptional cases where ideal system i.e. *Mushārakah* and *Muḍārabahah* can not be resorted to. Therefore it should be kept in view that *Murābaḥah* financing is:

(i) a transitory step towards Islamisation of the economy and
(ii) the conditions mentioned by scholars should be fully observed while issuing it as a product by Islamic Banks. Mere naming the 'interest' as 'markup' does not suffice.

Basic features of *Murābaḥah* Financings:

1. *Murābaḥah* is not deal in loan; it is *Bay' ul Mu'ajjal* having the characteristics of agreed profit added to the cost.

2. The conditions required for validity of a valid sale as enumerated earlier should always be fulfilled.

3. *Murābaḥah* can only be entered into if the client is actually buying some item or requires supply of some thing. Buy-back of an item or amount required for clearance of some bills/loans shall not be *Murābaḥah* in Islamic Law.

4. The item given as *Murābaḥah* should remain though for a while in the ownership of the financier before striking the deal.

5. The item should be in the possession (physical or constructive control) of the financier so as to constitute risk even if it is for a while.

6. Ideally speaking the financier should himself or through a third person (agent) arrange purchase of the item for the client. However the financier can also appoint the client himself as agent for this purpose.

7. Sale of a thing not in possession of the seller is not allowed in Islam. He can only promise for sale. This rule also applies in *Murābaḥah*.

8. <u>**Five steps:**</u> The steps enumerated hereunder should be adopted while making *Murābaḥah*:

- **I.** يرحتفانخیاعذ: Entering into an overall/general agreement promising sale/purchase by the financial institution and client on agreed profit.
- **II.** يرحتفانخیکی م: Entering into an agency agreement whereby the client is appointed as agent for purchase and collection of item from supplier.
- **III.** يرحتفانخ ًہک: Purchasing and taking possession of the item by the client in the capacity of agent.
- **IV.** يرحتفیجاباان ًربلحت: Intimation by the client to the financier about completion of the deal and makes offer for purchase by himself. Risk lies with financier in steps No. III and step IV.
- **V.** يرحتفلیالان ًربلحتبلنخمریظ: Acceptance of the offer of sale on installments by the financier. Now Risk is transferred to client.

9. The item should be purchased from a third person (Supplier). Buy-back by the financier from the client is not allowed.

10. The relation between financier and client in steps I, II, IV & V is that of promisor & promisee, principal & agent, vendor & vendee and creditor & debtor respectively. The

relation between the institution (financier) and supplier in step III is that of vendee and vendor. All these capacities with their consequential effects must be kept in mind while financing in *Murābaḥah*.

11. Security can be demanded by the financier in shape of promissory note or bill of exchange etc but it should be at or after fifth step and not the first step.

12. No penalty can be imposed on the client in case of default. The parties however can agree on compulsory charity (الخصاو الخ ظذق) but the financier must not consume or convert it to his assets. It shall be spent for charitable purpose only.

1. Different Prices for Cash and Credit Sales

Some people say it is not allowed to have different price for credit sale as it looks to be indifferent from interest charged by the conventional banks against lending. To reply this, following need to be taken into account.

'Capitalists' do not differentiate between 'money' and 'commodities' whereas there are three basic differences in the two. (a) Money can not be directly consumable for any human-need and is only a mean of exchange.)آلتان بـّدارت(The commodities on the other hand are consumable and are ultimate purpose of exchange.)يم ظى دان بـّدارت((b) Money is the only mean of calculation and exchange (a new and old currency note have same value عنو اعجار ل عًار); while the commodities vary in quality and specification (old and new cars of same brand have different value اعجار ل عًار) (c) The commodities can be specified in the contract)ٍ ى منعجى لب(while money does not)ٍ ى منعجى لب رىغ(. Based on these natural differences, the *Sharī'ah* Law allowed variations in exchange of commodities and disallowed variations in money. The case is same when the commodities are sold on credit or cash payment. Increase in case of credit sale is not unlawful if it is a deal of commodity because in calculating increase on original cost, some factors, other than late payment are also taken into consideration by both the parties, like easy approach to the shop by the purchaser, trust in vendor being a fair man, regular clientage between the parties and supply of items to the purchaser (being regular customer) even if it is short in market etc. These factors can lead to increase in price of commodity being considered for sale between the parties. This however is not allowed in exchange of money. All the schools of thought unanimously accept this. It must be remembered here that the

increase in original cost should be agreed in the beginning of contract. If it is not done and it is made as conditional with respect to late payment, it will become penalty against late payment of loan which is clearly a *Ribā*.

2. The use of Interest–Rate as Benchmark

The Financiers (Islamic Banks) while calculating *Murābaḥah* refer to IBOR (Inter Bank Offered Rates) for determining their mark up. It is not appreciable and a substitute system must be introduced for the purpose of making their own market. The Islamic banks/institutions can develop an Islamic Investment Fund. It may be kept in view that *Murābaḥah* is a *Ḥalāl* transaction if it fulfills the conditions. So mere using IBOR as benchmark for determining the profit does not render the transaction invalid. For example, Mr. A and B trade in liquor (*Ḥarām* trade) and soft drinks (*Ḥalāl* trade) respectively. Mr. A receives profit (say 10%) in his business. Looking this Mr. B also starts taking same percentage in his business. Mere linking of the percentages of the two trades does not *inter se* invalidates the *Ḥalāl* business.

3. Promise to Purchase

For the purpose of ensuring that the client may not retract from the *Murābaḥah*, the banks can be allowed to obtain a promise (undertaking) to this effect from the client. This would not be a bilateral forward-sale (بهى عيضافانيان سًخم م) agreement which is prohibited in Islamic Law as it is a unilateral promise only. Here another question arises whether this promise is enforceable in law or is it a moral obligation only. *Imām Abū Hanīfa, Shafeʿī, Aḥmad* and some *Mālikī* jurists say that it is neither mandatory nor enforceable. Another view is that it is enforceable through courts. A third view of some

Māliki jurists is that in ordinary promises it is not enforceable. However where the other party has taken certain initiatives/expenditures based on the promise, it is enforceable in law. This last version seems to be more apposite.

Some contemporary scholars have described that promise has been made enforceable by the jurists in case of *Tabarru'āt* (gifts تبرعات etc) only and not in *Moawiḍāt* (commercial monetary transaction معاوضات), but this view is not correct as some commercial transactions have also been made enforceable. Some jurists of *Hanafī* and *Mālikī* schools have permitted Bay' *bil Wafā* (بيع بالوفا whereby the purchaser of immovable property undertakes to resell the property to buyer if latter returns his price. Two verses (Bani Israel : 34 and Al-Saff : 2 & 3) and a number of traditions of Holy Prophet (SAW) can be located on the obligatory nature of fulfillment of promises on the basis of enforceability of promise of immovable property. (Resolution 2 & 3, Vth Conference of Islamic Fiqh Academy held in Kuwait 1409 AH. Journal 5, V.2, P.1599).

4. Securities Against *Murābaḥah* Price

The financier in order to ensure payment of *Murābaḥah* price, can obtain security in shape of mortgage, lien or charge subject to the following:

1. The security can only be claimed when the *Murābaḥah* deal with the client has taken place and there is a liability of debt (*Dain* دين). This security can also be claimed when the amount of *Dain* (*Murābaḥah*) has been fixed though physically the contract has not taken place.
2. The item sold (*Mabī'* مبيع can also be mortgaged as security. Some scholars say that for propriety of mortgage, delivery of item to the purchaser even for a while is

necessary. However this condition is not located in the books of *Fiqh*. Therefore possession is not considered to be mandatory prior mortgage.

5. Guaranteeing the *Murābaḥah*

The guarantee by a third person can be given in financing *Murābaḥah* in order to ensure timely payment by the client and recovery from the guarantor in case of default. The guarantee in today's practices is provided against charging some fee and not as voluntary transaction (*Tabrru'* تبرع). As per its original concept mentioned in the books of *Fiqh*, taking fee against provision of guarantee is unjust. This original concept is however being subjected to certain modification by contemporary scholars keeping in view the necessity involved in the case and there is no clear prohibitions of the same in *Quran* and *Sunnah*. Moreover the today's guarantee involves certain documentations and secretarial expenses. Therefore this issue needs further deliberation and re-look by the contemporary scholars.

6. Penalty of Default

To deal with defaulters in case of *Murābaḥah* is easy in countries where all the banks and financial institutions are *Sharī'ah* compliant as the defaulters can easily be blacklisted. But where the banks/institutions are not so, the solution given by some scholars, to force the defaulters to compensate the bank for the loss accrued to the bank, seems to be not well founded as it is *Ribā* ربا (Resolution 53, Vth Annual Session of Islamic Fiqh Academy, Jeddah, Journal 6 vol-1, p. 447). Besides blacklisting another solution is (*Iltizām-ut-Taṣadduq* التزام التصدق) in that, the client at the time of *Murābaḥah* may be made liable to deposit a certain amount into a charity fund

maintained by the bank/financier for welfare of poor and advancing *Qarḍ-e-Ḥasana* ق ر ض ح س ن to needy people. But this amount should not form asset of the bank/institution.

7. No Roll Over in *Murābaḥah*

In conventional banks the client can ask for extension in time for return of loan. The banks if agree can grant extension in payment of the loam with new rate of interest. It is called roll over. This is not permissible in Islamic Banks as *Murābaḥah* is not loan; it is a sale and resale of sold items is not allowed in Islam.

8. Rebate on Early Payment

As per basic *Sharī'ah* Law asking for rebate in amount against early payment is not permissible according to the four schools of thought. Few scholars have however allowed it. It can be concluded from the arguments of these scholars that provision of rebate on early payment cannot be made a condition in the agreement. However if a bank or financier voluntarily provides rebate in the amount it is not unlawful (Resolution 66, VIth Session, Journal 7 Vol 2, p 217).

9. Calculation of Cost in of *Murābaḥah*

Ascertaioning the cost incurred on acquiring a commodity at very initial stage is must to constitute a *Murābaḥah*. However if different currencies are involved i-e PKR and US$, then *Murābaḥah* can either be achieved by striking the deal in the currency in which the financier has paid the price (i.e. US$) or the US$ may be converted to PKR and the amount expended in this behalf may be considered as originally determined cost and with its reference profit in *Murābaḥah* can be fixed. If the

bank has purchased the item on installments or on credit sale the cost of PKR as compared to US$ of future period can not be determined due to fluctuation. In such a case either (a) bank should purchase it on Letter of Credit at sight (cash payment) or (b) *Murābaḥah* with client may also be done in US $, or (c) the deal is to be completed as *Musāwamah* instead of *Murābaḥah*.

10. Subject-Matter of *Murābaḥah*

The items that can be lawfully sold on profit can be made subject matter of *Murābaḥah*, so shares of a Lawful Company can be sold/purchased as *Murābaḥah*, but subject to conditions of *Murābaḥah* as explained earlier. Currencies can not be sold on *Murābaḥah* as their sale must be spontaneous or, if deferred, at the market rate prevalent on the day of deal. Similarly the commercial papers representing a debt or receivable money by the holder can not be subject matter of *Murābaḥah* being *Ribā*.

11. Rescheduling of Payments

Rescheduling of loans practiced in conventional banks is not permissible in Islamic Law. Some Islamic banks have suggested to reschedule the price into a different hard currency but this can also not be allowed as rescheduling must always be on the basis of same currency.

12. Securitization of *Murābaḥah*

Murābaḥah can not be converted into negotiable instruments so as to attain a secondary market because when such a certificate is made/signed by the client, it only denotes his having indebted to the amount shown on the certificate. So selling this certificate would amount to exchange of money for

which it is mandatory to be equal in quantity (counting). So generally such kind of certificates are not allowed. However if there is a mixed portfolio consisting of *Mushārakah*, *Murābaḥah* and *Ijārah*, the negotiable certificates can be issued subject to the conditions enumerated under the heading "Islamic Investment Funds".

1. Since *Murābaḥah* is not a financing mode, it can only be used when the clients intends to buy an item. Therefore it cannot be used for general financing like clearance of overhead expenditure, payment of salaries, and utility bills etc.

2. Some times documentation is carried out for obtaining loan only, and the item is only mentioned to satisfy the requirement. The banks should avoid such kinds of deals by adopting one of the ensuing options:

   a. to pay the amount to the supplier directly.
   b. to ask for invoice from client.
   c. to arrange for inspection of the item physically after receipt by the client.

3. The steps (already mentioned) of *Murābaḥah* are not followed strictly whereby the item is sold on *Murābaḥah* from very beginning, which is not permissible.

4. For liquidity management, the Islamic Banks resort to certain kinds of international commodity deals, considering them asset-based transactions but ignoring the fact that international market does not conform to *Shariah*. The deals either are fictitious, or there is forward sale (بيع مضاف إلى المستقبل) or short sale (بيع ما ليس عنده), which is un-Islamic, e.g brokers make deals on Internet or E-mail and sell it to client on the basis of *Murābaḥah Muajjalah* مرابحة مؤجلة The brokers some times re-purchase it from the client, which amounts to either forward sale or short sale, and both are not permissible.

5. Some banks also deal in *Murābaḥah* on items already purchased by client from third party. In this case if the bank wants to purchase it from the supplier/manufacture, it can not, because supplier is no more owner; and if it is purchased from the client it is buy-back and both are not permissible.

IJĀRAH

اجاره

Lexically, it means to give some thing on rent: In Islamic law the term is used for two situations.

1. *Ijārah al-Ashkhas* اجارة الأشخاص (Hiring Human services). It is further divided in:
   (a) Ijarah *Alal Waqt* اجارہ عیانوقت - on monthly or periodical salary, or
   (b) Ijarah *Alal Amal* اجا ر عیانعمل on provisions of services, e.g. hiring a porter at air port or a 'cooli' at Railway station.

2. *Ijārah al-Ashya'* اجارة الأشياء (Hiring usufructs of property): This is synonym to English term 'leasing'. In this case 'Lessor' is called *Mujir* مؤجر the 'Lessee' is called *Mustajir* مستاجر and 'rent' is called '*Ujrah*' اجرت . In this chapter the second type of *Ijārah* will be dealt with.

Ijārah and sale have identical rules. In both, some thing is transferred to another person for valuable consideration. The only difference between the two is that in *Ijārah* corpus of property remains with the owner; only usufructs are transferred to lessee (*Mubadalatul Māl bil Munfa`at* مبادلۃ المال بالمنفعۃ: In case of sale, the corpus of property is transferred to the buyer against wealth (*Mubadalatul Māl bil Māl* مبادلۃ المال بالمال

Basic Rules of Leasing

1. In leasing usufructs of an item are transferred to another person for an agreed period against agreed consideration.
2. Subject matter of leased item must be valuably useable.

3. Ownership must remain with the lessor and the item should not be consumable.
4. Liabilities associated with ownership (property tax etc) and those associated with possession (utility bills etc) must be borne by the lessor and lessee respectively.
5. Period of lease must be specified.
6. Lessee can not use the lease property for purpose other than the one specified by lessor or by custom of that area.
7. Damage caused due to, misuse or negligence shall be compensated by lessee.
8. Risk of damage of lease property will remain with the lessor.

9. Joint property can also be leased, the income being equally divided as per share of owners in the property.
10. Joint property cannot be leased unilaterally to third a person.
11. Lease property should clearly be specified in agreement.
12. Rent must be specified as a whole for the entire period of lease. The rent can also be different for various tenures of lease but it must be specified in the beginning.
13. Rent can also be fixed while calculating total expenses incurred by lessor on the property as is done in financial leasing by conventional banks.
14. Rent can not be increased unilaterally by the lessor nor can such a condition be included in lease agreement.
15. Rent or a portion of rent can be paid in advance but it must be adjustable in final rent.
16. *Ijārah* will be deemed to have been created from the time of taking over the property by the lessee.
17. *Ijārah* will be deemed to have been terminated from the date if the property has lost its function and is not repairable. In case of negligence the lessee will however be liable to compensate the lessor for loss.

IJĀRAH (LEASE) AS MODE OF FINANCING

Originally *Ijārah* (lease) is not a mode of financing. Therefore in an attempt to adopt it as mode of financing many basic features have been ignored by some of the financial institutions, which has rendered it a 'financial lease' which is distinct from 'operational lease' allowed in Shariah law. In this regard following points may help in differentiating between financial and operational lease.

1. Commencement of Lease:

Ijārah can be made applicable from a future date; the sale on the other hand can not be made applicable from a future date (forward sale is not allowed). Moreover it has been found in lease agreements of some banks that lessor is made responsible to pay rent from the day of payment of price of lease property by the bank whereas the property has still not been purchased. This tends to be rent of the amount given to the lessee, which is *Ribā* in clear terms.

2. Different Relations of the Parties

When lessee is entrusted to purchase the property, two capacities are set, *Wakalah* and *Ijārah*. Both these steps can not be mixed nor made interdependent and should be treated isolately in two time frames. Here it may be noted that *Ijārah* leasing is different from *Murābaḥah* leasing in the sense that after taking over by the client as agent, he may start using it, as *Ijārah* on the basis of agreement is already entered with the financier. This is not the case in *Murābaḥah* leasing as that involves risk to be transferred to the client prior entering in *Murābaḥah*.

3 Expenses Consequent to Ownership:

The lessor being owner of the property is to bear the expenses associated with the ownership (property tax, insurance etc فَماث اِخ ہً ك). The lessee may however pay expenses associated with possession (Utility bills etc فَماث الَقعا). In financial lease both are levied from client, which is un-Islamic.

4. Liabilities of Parties in Case of Loss to the Asset:

The lessee can be held responsible for damage caused due to misuse or negligence. He can also be made liable for fair wear and tear. In the factors beyond his control (فِآل جس ً اوىّ), the lessee can not be made liable. This difference which is not considered by financial lease must be kept in view by Islamic banks while entering in *Ijārah*.

5. Variable Rent in Long Term Lease:

In solving the problem of rent in long term lease, some Islamic banks resort to IBOR as benchmark, which is objected by some scholars. It may be clarified here that the rent fixed can be made variable by referring to some benchmark like IBOR, taxation percentage, etc. Referring to interest as mere benchmark is not prohibited till the time risk is borne by the financier. In financial lease risk is borne by the client, which is un-Islamic. Although, due to this benchmark the rent remains unknown this *Jihālah* of rent *inter se* is not prohibited if there is no risk of confrontation (*Nizā'* سَاع) or cheating (*Gharar* غرر) between the parties. Some contemporary schools have allowed fixing a leverage in percentage (5-15%) in order to overcome the issue of *Ijārah*. This seems to be more appropriate.

6. Penalty for Late Payment of Rent:

Financial penalty imposed by financial leasing is prohibited in *Sharī'ah* law in case of late payment or default. However, compulsory charity (*Iltizām ut Taṣadduq* التزام التصدق) for a fund maintained by the bank for welfare of poor people can be resorted to as a check on timely payment by the lessee.

7. Termination of Lease:

On violation of terms of contract lease can be terminated unilaterally by the lessor. Otherwise it can only be terminated mutually. Right of termination by the lessor arbitrarily is against the Islamic injunctions. Moreover binding the lessee to pay the rent of the period after termination of lease as practiced by some Islamic banks similar to financial lease agreements, is against the *Sharī'ah* Law.

8. Insurance of Property:

If insurance (*Takāful* تكافل) of the property is taken, it should be at the expense of lessor and not the lessee as is noticed in documentation of some Islamic banks. The practice, similar to that of financial lease need to be stopped in *Takāful*.

9. Residual Value of Leased Asset:

If *Ijārah* agreement contain a condition that on completion, the property shall be handed over to the lessee it is against Islam. Two simultaneous deals being one pre-condition for other in one deed are (*Ṣafaqatain Fi-Ṣafaqah* صفقتين في صفقة) not allowed. A solution to this problem is that a unilateral promise may be given by the bank that on conclusion of *Ijārah*, the item will be handed over to lessee. This can be

undertaken by either of two promises i.e. a separate *'Ahd al Bay'* عهدالبيع or an *'Ahd al Hiba* عهدالهبة.

10. Sub Lease:

Sub lease is not allowed except with the express consent of lessor and subject to the condition that rent should be equal or less than the rent being paid by him to the lessor. If it is more than the rent, it is lawful in the point of view of *Imām Shāfe'ī* and *Ḥanbal*. *Imām Abū Ḥanīfa* says that the lessee may not use the surplus as he does not have risk of the property. So the amount being received in excess amounts to *Ribā*. However if sub-lessor has made some alterations in the property or deal is struck in a different currency, excess amount is allowed.

11. Assigning of Lease

The lessor can sell the property (ownership ملكيه المستأجر) to a third person whereby he becomes the lessor himself and original lessor is out from scene. On the other hand the lessor cannot assign the rent received in the lease حك و طوك الاجرة to a third person on an amount more than the rent, as sale or assigning of receivable loan (rent in this case) is not allowed with unequal amount as it becomes *Ribā*.

12. Securitization of *Ijārah*:

In order to create secondary market, certificates of *Ijārah* can be issued based on sale in parts of the ownership in the leased property. It should be kept in view that while designing a certificate, rights and duties to the extent of rental only in the property (without transferring ownership) is not allowed. In other words certificates of rent are not allowed; only certificates of ownership of lease property are allowed. In such

a case, the certificate-holders shall receive proportion of rent as per their share and shall also be liable for losses, if any, being lessor.

13. Head Lease:

Subletting of the leased property is allowed as discussed earlier but if the lessee sells the usufructs by inviting others to participate in the business and gives them share in the rental of sub-lease, it is called head lease, which is not allowed because the lessee does not own the property. He is only entitled to usufructs of the property. By subletting his right, the usufruct is also transferred to sub-lessee; therefore he does not remain entitled to receive the share in rent.

SALAM

سلم

A sale can only be allowed if (a) it is about a thing that exists, (b) is owned by and (c) is in physical or constructive control of the vendor. Out of this general rule, two kinds of sale have been excepted i.e. *Salam* سلم and *Istiṣna‘* استصناع

Salam: is a sale in which vendor takes the responsibility to provide a particular item in future in exchange of money fully paid in advance. The vendee in this sale is called *"Musallam Ilaihe"* مسلم اليه the vendor as *'Rabbus Salam'* رب السلم and the item as *"Musallam Fīhe"* مسلم فيه

Due to some agricultural and business needs of people the Holy Prophet (SAW) had permitted the deal of *Salam*.

Conditions for *Salam*

1. The vendor should pay the entire price in advance.
2. *Salam* is allowed only of the items whose quality and quantity is well known.
3. *Salam* is not allowed about production of a particular garden or farm as there is likelihood that the production is not received at all.
4. The kind (*Jins* جنس) description (*Naw‘* نوع) and quality (*Waṣaf* وصف) of the *Musallam Fīhe* must be known.
5. The quantity of both the measurable commodities (*Makīlāt* مکیلات) and weighable commodities (*Mawzūnāt* موزونات) of the *Musallam Fīhe* must be known/ described beyond any doubt.
6. The date and place of delivery must also be known.

7. *Salam* is not allowed of the six items that are required by *Sharī'ah* to be exchanged at spot i.e. sale of gold, silver, wheat, barley, dates and salt.
8. In *Ḥanafī* School, the existence of *Musallam Fīhe* at the time of sale (transaction) is necessary. The other schools of thought have not put this condition and it is only necessary that the thing exists at the time of delivery. This point of view seems more apposite in today's perspective.
9. In *Ḥanafī* and *Ḥanbalī* schools, the date of delivery must not be less than one month. In *Mālikī* School it must not be less than 15 days. The *Shafe'ī* and some of *Hanafī* scholars have not agreed to this restriction. This seems more apposite.

SALAM AS A MODE OF FINANCING

Salam is workable as financing in modern Islamic Banking. As the price in *Salam* is normally less than the original price, the margin will constitute profit of the bank. For this purpose guarantee (in shape of mortgage) can also be taken from the client. Since the banks do not deal in items as they deal with money, following measures can be adopted for solution of this problem:

a. The bank may establish a special cell for dealing in commodities/items.

b. To sell the item through a parallel contract of *Salam* and because in the parallel *Salam*, less time for the delivery would by involved, and the price shall be more. This margin shall be considered profit of the bank.

c. The bank can take promise of purchase of the item from a third person. In this way the bank can also earn more profit.

d. Some banks/institutions resell the item to the "*Musallam Elaihe*" which is not permissible in Islam.

Some Rules for Parallel *Salam*

1. The banks have two different capacities of buyer and seller in parallel *Salam*. So the two contracts should be independent of each other and should not be interlinked, as there may be risk of delay in delivery or risk of provision of non-standard item by the first client, which may cause problem amongst the parties.

2. Parallel *Salam* can only be entered with third person and not the first client as it amounts to buy back which is not allowed in Islam.

ISTIṢNĀ'

سٹصناع

To order a manufacturer to manufacture a particular item for the purchaser, with the raw material to be arranged by the manufacturer. The consent of both the parties and specification of the item must be pre-determined.

Difference Between *Istiṣnā'* and *Salam*

1. *Istiṣnā'* can only be made of the item to be manufactured in future; the *Salam* can be of any item whether manufactured or supplied.

2. In *Salam* advance payment is must, in *Istiṣnā'* it is not so.

3. *Salam* can not be cancelled unilaterally, *Istiṣnā'* can be cancelled by purchaser before start of work by the manufacturer.

4. Time of delivery is must for *Salam*; In *Istiṣnā'* it can be without any such fixation

Istiṣnā' & Ijārah

1. In *Istiṣnā'* the raw material is not provided by the client (purchaser); in *Ijārah Āla al 'Amal* it is provided by the *Mustājir*.

2. In *Ijārah* there is option of rejecting the item after looking (*Khiyār-ur-Ru'yat* خيارلرؤ ج) while in *Istisn`a* after preparation of the item, "*Khiyār-ur-Ru'yat*" can be exercised by the client as per *Imām Abū Ḥanīfa*'s point of view. *Imām Abu Yusuf* however says that if the item is

manufactured as per specifications, the *Khyār* خيار can not be exercised. This view is more apposite in today's business.

Time of Delivery

It is not necessary to fix time of delivery in *Istiṣnā'* but maximum limit can be given; thereafter the client can refuse the acceptance. Can the parties agree at the time of contract that if the item is prepared within time the fee will be more and if it is delayed the amount will be decreased? The classical writings are silent on the issue with respect to *Istiṣnā'*. However taking analogy from the *Ijārah* where such clause is permitted *Istiṣnā'* may also contain such clause.

ISTIṢNĀ' AS MODE OF FINANCING

Istiṣnā' can be used as mode of financing in any of the following three ways.

1. **House Building financing:** For construction as well as acquisition of plot and construction House Building financing can be launched under *Istiṣnā'* mode. Since time of payment is not mandatory therefore it can be in installments. Similarly the financier can undertake construction, through a parallel *Istiṣnā'*, or an independent contract but he should be some one other than client. The installment can be started soon after the contract. The timely payment of installments can be ensured by retention of property's documents with financier. In case of deviation from the agreed design, the client can demand compensation.

2. **Project Financing:** *Istiṣnā'* can be undertaken for particular projects like Installation of A/C Plant in a factory etc in which case a manufacturer can be given the *Istiṣnā'* contract by financier.

3. **BOO and BOT projects:** *Istiṣnā'* can also be done for mega projects on BOO/BOT (Build, own and operate/transfer) basis, e.g. construction of highways by a builder. As per contract of BOO/BOT, the price of the project will be that the builder will operate the highway and collect tolls.

ISLAMIC INVESTMENT FUND

Fund means a joint pool where investors contribute their investments for earning *Ḥalāl*. Certificates to this effect can be issued to the investors entitling them pro rata profits actually earned by Fund. Basic principle for the funds is that the business to be undertaken by the Fund must not be prohibited by Islam and should be as per *Sharī'ah*.

Equity Fund:

In equity Fund, amounts are invested in shares of joint stock companies doing lawful business as per *Sharī'ah* Law. Companies are rarely found which fully adhere to Islamic law. A group of scholars does not allow taking share of an Islamic company that undertakes Islamic business but also borrows money on interest basis. However a number of scholars have allowed this, by bifurcating the case of an ordinary company (where share holders have veto powers) and joint stock company (no veto powers with share holder). While it is not within the powers of the shareholder to veto in joint stock Company, he can raise this point in Annual General Body Meeting in order to be absolved from the religious liability. He should also deduct the interest amount from his annual dividend.

Conditions for Investment: Based on this point of view, following conditions prior investment in share can be taken into account.

1. Main business of the company should be *Sharī'ah* compliant.

2. If a company is doing *Ḥalāl* business but borrows money on interest, the shareholder must express his disapproval preferably in AGM (annual general body meetings).

3. If some portion of interest is included in annual dividend it must be given in charity by the shareholder.

4. Certificates are only negotiable if the company beside liquid assets also owns some non-liquid assets.

The proportion of non-liquid assets to make a company's share negotiable should be at least 51% (majority) as per first opinion. Other view is that it may be 33%. *Hanafī* jurists say that no exact proportion is not required but it should be kept in mind that:

(a) the proportion should not be negligible and,

(b) price of certificate should be more than the value of liquid portion.

The profits of the share can either be earned by dividend or through appreciation of amount. Some amount of dividend that corresponds to interest must be given in charity. This process is called purification. Some scholars say it is a must, while others say that the amount of interest is negligible, therefore purifications is not necessary. The first point of view is more precautious.

Management of funds can be done by *Muḍārabah* mode. In this case the managers will get their share in profits only. The management can also be done by *Wakālah* (agency) basis i.e. on pre-agreed *wakālah* fee.

Ijārah Fund:

Properties, vehicles, equipments are purchased through this fund for leasing. The rental income is distributed pro-rata to the subscribers against the certificates (*Ṣukūk*) held by them showing their share in the fund. The *Ṣukūk* being recognized in *Sharī'ah* law are negotiable. All principles of *Ijārah* must be kept in mind while creating this fund, which is different from conventional funds in the following ways.

1. The asset should have usufructs and rent is actually charged after handing over to *lessor*.

2. The asset must be so to be used in *Ḥalāl* way.

3. The lessor should accept and undertake liabilities associated with ownership.

4. Rental must be fixed and known to both parties right at the outset of the project.

This fund can be managed through *Wakālah* (agency) on fixed amount or proportion in rentals received. Most schools negate its admissibility by way of *Muḍārabah*. However *Ḥanbalī* School has allowed it. Contemporary scholars also prefer this view.

Commodity Fund:

In this fund different commodities are purchased for resale. Following rules governing the transactions must be complied with:

1. The commodity must be owned by the seller at the time of sale (short sale not allowed).
2. Forward sale are not allowed except for *Salam* and *Istiṣnāʿ*.
3. The commodities must be *Ḥalāl* (pork, wines not allowed)
4. Seller must be in physical /constructive possession of the commodity at the time of sale.
5. Price must be fixed and known to the parties.

***Murābaḥah* Fund:**

Commodity is purchased for the benefit of client and sold to him on cost-plus basis. This type of fund must be closed-end fund and its units can not be negotiable in secondary market because no non-liquid assets are owned by the portfolio of *Murābaḥah*.

Bayʿ- al-Dain (بيع لدىه)

Sale of debt is not allowed by majority of traditional as well as contemporary scholars except some scholars of Malaysia who refer to *Shāfeʿi* School which allows sale of debt. These scholars have ignored the fact that sale of debt is allowed if it is at par value. If there is an increase or decrease, the *Bayʿ-al-Dain* is clear form of *Ribā*.

Mixed Fund:

This fund may be mixture of more than one type of Islamic funds already discussed. If the tangible assets of the fund are more than 51%, its units may be negotiable. Otherwise it must be closed-end fund.

PRINCIPLE OF LIMITED LIABILITY

A condition under which a partner or shareholder secures himself from bearing the loss greater than his investment in the company, is called limited Liability in contemporary corporate sector. The purpose of this factor in corporate body was to attract the maximum investors. This is a new concept as far as *Sharī'ah* Law is concerned. Deriving some principles from Holy *Qur'an, Sunnah* and *Fiqh,* a *Mujtahid* can find out some answers on the issue. The ensuing discussion is my personal opinion and not a final verdict on the issue.

Limited liability is closely related to the concept of juridical personality of modern corporate bodies. A company enjoys a full-fledged entity of rights and duties just like human being (person). If Islamic Law accepts this concept of juridical person, then question of limited liability can be easily solved. A man can die insolvent, and the creditors have no claim except to the extent of his assets. Applying this principle of insolvency, a company can also be declared insolvent having been died/liquidated.

1. ***Waqf* (وقف):** It is a legal and religious institution where property is dedicated for religious or charity purpose. After making *Waqf* the ownership is shifted from donor to *Almighty Allah* and people can only be benefited as beneficiaries. *Waqf* and Mosque can own money, transact sale and purchase, may become debtor/creditor and can sue or be sued. It means they are juridical person.

2. ***Bait ul Māl* (بیت المال)** The exchequer of Islamic state is public property not owned by any one. It has certain rights and duties; even different department in *Bait ul Māl* can borrow and advance loans from each other being an

independent entity. Hence *Bait-ul-Māl* can be treated as debtor/creditor and can sue or be sued by each other. This is another example of juridical person.

3. **<u>Joint Stock (خلطة الشيوع):</u>** According to *Shāfe'i* school of thought if more than one person run joint assets' business, *Zakāt* will be levied on each of the partner individually but will be payable on joint stock and if assets of one partner do not reach *Niṣāb* even then he has to pay in joint stock, if it reaches the *Niṣāb*. *Khalṭat-ul-Shuyu'* principle is also applied to levy *Zakāt* on Livestock which is also accepted by *Mālikī* and *Hanbalī* schools. It means joint stock is treated as separate entity capable of rights and duties. The concept of juridical person is very much there in this transaction.

4. **<u>Inheritance under Debt (تركة مستغرقة في الدين):</u>** When liabilities of a deceased exceed his assets, jurists say that his assets would be considered neither owned by deceased, nor his heirs nor creditors. Still, they have existence that can be termed a separate legal entity. The heirs or the nominated executor only manages the assets and any expense in the process is charged from assets. So it has characteristics similar to those of a juridical person.

5. **<u>Limited Liability of Master of a Slave (العبد المأذون):</u>** Closest example to limited liability is that of a slave who was allowed (*'Abd-al-Ma'zūn*) by the master to enter into trade with the money of the master. If slave incurred debts the same would be set off with the money in hand of the slave or even by sale proceed of the slave himself, but liabilities were never turned to the property/assets of the master for clearance. It means that the master had limited liability.

In the end it may be clarified that the concept of limited liability should be restricted to public joint stock companies or for sleeping partners of private companies only.

PERFORMANCE OF ISLAMIC BANKS - A REALISTIC EVALUATION

Islamic banking is undeniable reality now. A large No of Islamic Banks are being established, conventional banks are opening Islamic Windows even non-Islamic financial institutions are also entering the field. The three decades' performance of these banks is therefore required to be evaluated to advance towards ultimate success.

ACHIEVEMENTS:

1. One of the remarkable achievements of the banks is that they set practical example of interest-free banking. They courageously translated the theory into practice.

2. They work under *Sharī'ah* Advisory Board which made them consult '*Ulemā* wherever need arises which assisted the '*Ulemā* to understand modern business market and provide the solutions under *Sharī'ah* Law.

3. Islam provides solutions to every emerging problem. It means that *Qur'an* and *Sunnah* provide broad principles and '*Ulemā* on the basis of *Istinbāṭ* (اسخُباط)and *Ijtihād*)اجهاد(provide solution to them. For about last three centuries this system of derivation and solution to the emerging problems had been held in abeyance. Islamic banks have greatly contributed towards restoring the wheel of evolution of Islamic legal system particularly in the field of business and economy.

4. Most importantly the Islamic banking sector has now entered the international market and attained world-over

recognition, which compelled the conventional banks and even non-Muslims are resorting to Islamic banking.

DEFICIENCIES:

Conversely there are certain deficiencies as well, which also need evaluation.

1. **Neglect to Switch Over to *Mushārakah***: Philosophy of interest-free banking is aimed at establishing distributive justice free from exploitations that is prevalent in the society due to interest-based banking. Islam provides solution to injustice and exploitation through the system of *Mushārakah.* Unfortunately this basic concept of gradual shift over to *Mushārakah* is neither undertaken nor there seems to be any such plan by the Islamic banks.

2. **Ignoring Certain Important Things:** Due to above noted lapse, the banks seem to be strict to *Murābaḥah* and *Ijārah* that too under the frame work of IBOR (inter-bank offered rates). While doing so, they have not appreciated that:

(a) originally these two are not modes of financing,
(b) The permission granted by *'Ulemā* for resorting to *Ijārah* and *Murābaḥah* should be taken as interim measures and not as permanent rules to extent that the entire sector start revolving around these two modes,
(c) This dubious transactions akin to conventional banks also create doubts in the minds of people who are otherwise sincere towards Islamisation of banking sector,
(d) After adopting these two devices by almost all the Islamic banks as regular fashion, it has become difficult to justify the system to masses, particularly non-Muslims who feel that it is nothing but twisting the documents.

3. *Murābaḥah Fasida*: Many Islamic banks are not following the set pattern/procedure for financing *Murābaḥah* and *Ijārah* like:

(a) possession (whether physical or constructive) of the item being provided on *Murābaḥah* or *Ijārah* must be taken by the bank even for a while to constitute risk on his part which is not practically done by some banks,
(b) *Murābaḥah* can only be of an item actually required by the client. Some banks enter *Murābaḥah* for provision of funds to the clients for over-head expenditures, payments of salaries of staff etc which is not allowed under Islamic Law,
(c) Some time, client enters *Murābaḥah* for financing one of his already purchased item. This amounts to buy-back which is against Islamic law,
(d) in case the client is authorized as agent (*Wakīl* وکیل) for purchase of item, this capacity should be separate from his later capacity of buyer (مشتری) having different liabilities. The banks normally do not care for their segregation, (e) Penalty for default or late payment is not allowed in Islam. Some banks have been found increasing amount of *Murābaḥah* on this pretext, which is against the Islamic Law.

4. ***Ijārah Fāsida:*** Essence of *Ijārah* is that risk of damage/destruction remains with bank and bank provides usufructs of the item to the client against rent. Some banks have been found charging rent from client even if the item is damaged/lost due to force majeure, which suggests that the risk has not been with the bank.

5. **Linking Profits with Rates of Conventional Banks:** Islamic banking is totally different from conventional banking.

So it is not necessary that both give similar result while doing business. Linking of the profit earned by Islamic banks with the rates of conventional banks is not a legitimate practice.

6. **Moral Obligation toward Society:** Business transactions can not be separated from moral objectives towards the society, e. g. caring for needs of people, particularly, those small traders who really need assistance. New products of House Financing, Vehicles Financing and Rehabilitation Financing etc with distinct features need to be launched keeping in view of society's problems.

7. **Establishment of Mutual Fund:** Islamic banking can not advance without strong system of inter-bank transactions. Lack of such system force them to the conventional banks for their short-term needs of liquidity in which *Ribā* is involved. For this purpose a *Murābaḥah* cum *Ijārah* fund can be established by the Islamic banks/institutions of the world across the globe.

8. **Caring for Islamic Values:** The Islamic banks need to develop their own culture based on Islamic values. The outlook of banks and their staff should reflect Islamic identity. This requires a major overhaul. Some Middle Eastern Islamic institutions/banks have shown advancement towards this aspect, but it should be a distinct feature of all the Islamic banks of the world for which guidance of *Sharī'ah* beard can be sought.

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About Author

- Shafiq ur Raḥman was born in 1971 in Punjab, Pakistan;
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